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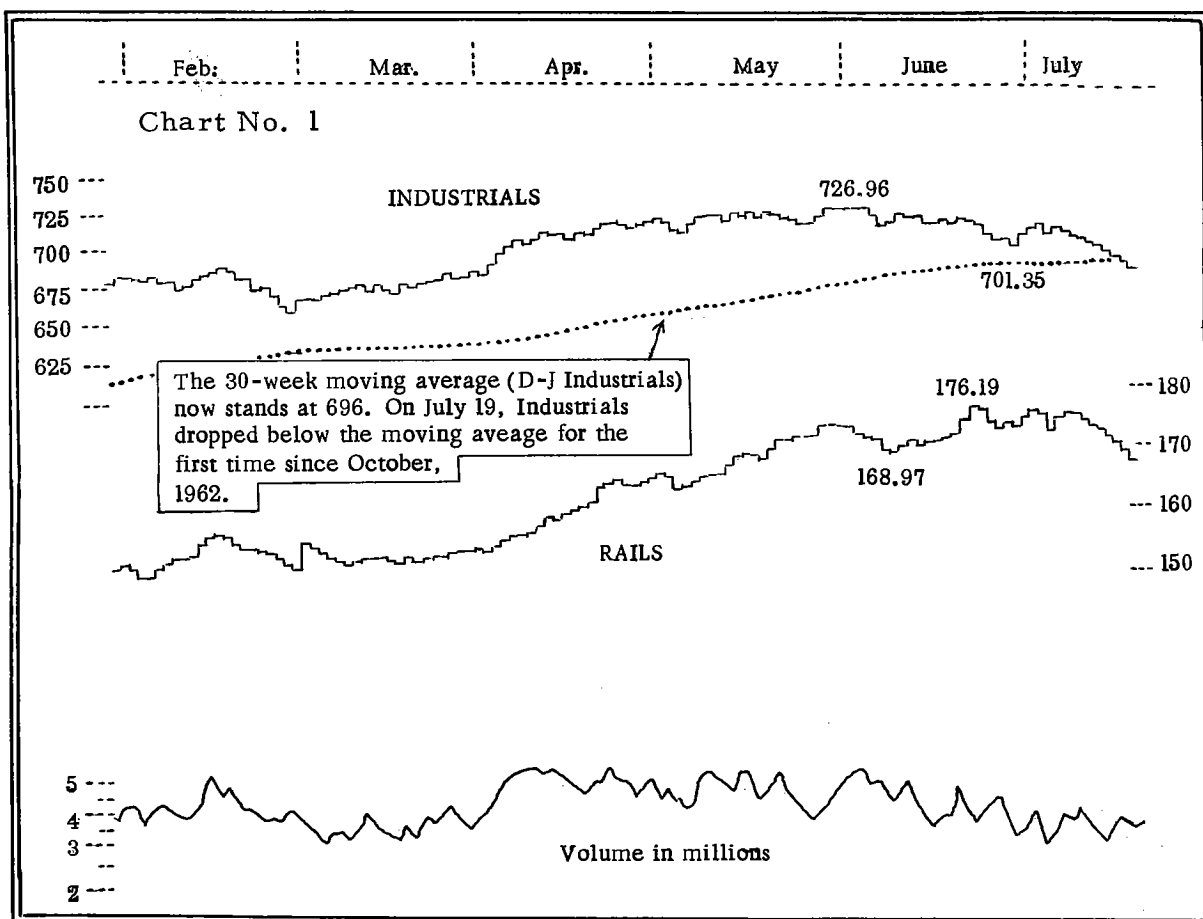
**THE MARKET** Last week was a symphony in bad news. First the Federal Reserve raised the discount rate a full  $1\frac{1}{2}\%$  to  $3\frac{1}{2}\%$  (a move already discounted by the market); then the S. E. C. issued a much rougher than expected report with suggested "improvements" for the securities industry; next President Kennedy rocked foreign markets with the suggestion of a 15% tax on foreign security purchases; and finally to add insult to injury the Fed announced that the U.S. had lost another \$50 million in gold (can we blame anybody for grabbing their gold?)

Recent Letters have stressed two important market considerations: (1) The Industrial Average has violated the lower trendline of a giant "rising wedge" pattern, an action which must be considered bearish. (2) The two Averages then formed a sideways structure or "line".

According to Dow's Theory, the actions of both Averages must be considered if correct inferences are to be drawn. The lower limits of the line structure were stated to be 701.35 for Industrials and 168.97 for Rails. On July 17, Industrials broke well below their 701.35 lower line limit. That bearish penetration was confirmed by Rails on July 22, a day which saw the carriers sink beneath their own lower line limit of 168.97.

Readers should note that July 22 marked the ninth consecutive day of loss for the two Averages. The situation has now become heavily weighted on the downside, and the normal expectation would be for a corrective rally to start at any time. Nevertheless, as far as Dow's Theory is concerned, a long "line" structure has been broken by both indicators. The implications are obvious: the action of the market during April through July constituted a period of distribution. Penetration of the lower limits of the line area meant that the market had absorbed as much stock as it was able. On July 19 (the day of the Industrial penetration) and July 22 (the Rail penetration) the sellers overcame the buyers, and the line structure cracked.

Robert Rhea wrote that the breaking of a line almost always signifies a change in the secondary trend, while at times it signifies a change in the primary trend. For this reason, the writer would now handle long-term investments as if all trends were bearish. This means unloading on the next rally. Furthermore, if the quality of the next rally is poor, traders will be entitled to put out shorts. Short sales should be executed after a rally -- when the market turns dull.



**BUYING AND SELLING PRESSURE** This issue contains a weekly chart of the buying and selling pressure lines and the Industrial Average rather than the usual daily chart. The weekly chart (chart #2) is particularly interesting since it shows the subsurface action of the market as Industrials traced out their recent giant "rising wedge" pattern.

As discussed in previous Letters, the Industrial Average advance has been contained within two converging trendlines (A and B on chart); and this formation is known as a rising wedge. It is a structure which is associated with bear market recoveries rather than bull market advances. A normal bull advance tends to hold within parallel rising lines rather than converging lines. The inability of the rally peaks (bordered by trendline A) to form a line parallel to trendline B is a sign of weakness, and the appearance of the rising wedge pattern is indicative of a thrust which is gradually losing its upward momentum. The actual breaking of the wedge came about seven weeks ago (see Letter 219).

The fascinating thing about this study is that the buying and selling pressure lines have confirmed the Industrial price structure. Note that the height of buying pressure occurred in late November and early December, 1962. A slight bearish cross-over took place in late December followed by another rise in buying pressure in January, 1963. The January peak in buying was considerably below the November peak, and this implied diminishing buying interest. Another mildly bearish crossover occurred in March, and in April buying pressure rose above selling for the third time. The April-June rise in the buying line was noticeably feeble, but it provided enough strength to take the wedge to its apex.

On June 7 selling again rose to the dominant position, and this corresponded to the final rupture of the wedge pattern. As seen on the chart, selling pressure has now risen to the highest point since October, 1962 while buying has dropped to the lowest level since then. Selling pressure has been the dominant factor for 31 days. It remains for volume (which so far has not been heavy) to tell us how bad the situation is fated to be.

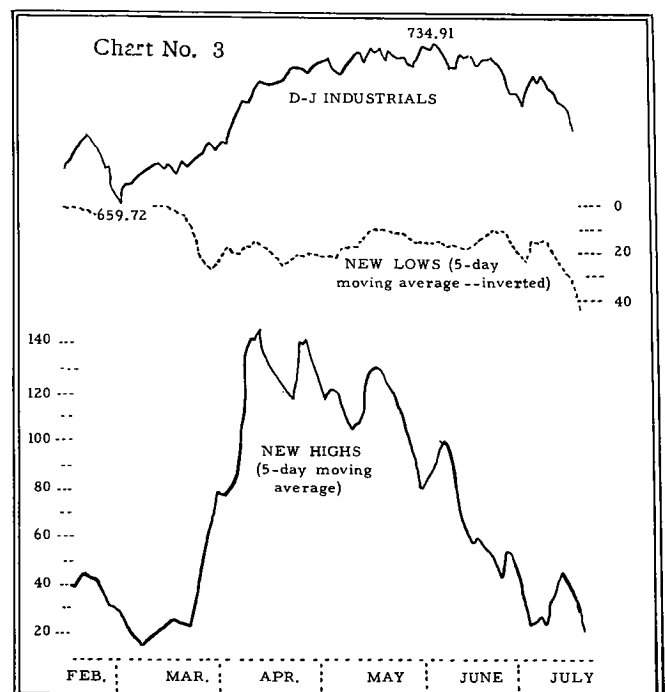
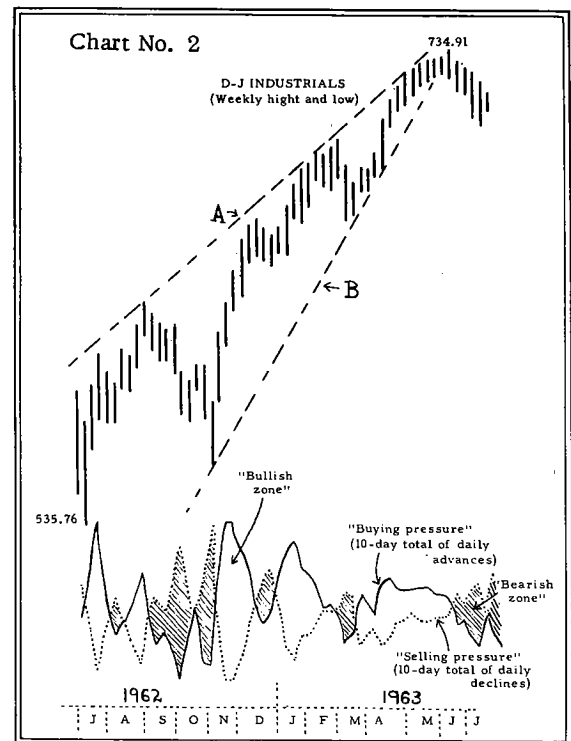
**TECHNICAL FOLLOW - UPS** Letter 221 presented the daily "new high and new low" picture, and attention was directed to the collapsing 5-day average of new highs. On July 18, for the first time in 1963, the 5-day average of new lows exceeded the 5-day average of new highs, an unmistakable sign of technical deterioration. On the same day (see chart #3) the new low line expanded to 37 which was considerably more than the previous high total of 29 established in June. The meaning: not only has the upward momentum on this move terminated, but more and more stocks are now breaking out of their patterns and recording new 1963 lows. Such action in the past (while not precluding new highs in the Industrial Average) has usually been associated with a major peak in the A-D ratio.

Tri-Continental warrants broke last week to a four-month low of 35 (see Letter 224). These sensitive shares have now traced a definite downward zig-zag after breaking below their rectangle formation. This must be taken as an adverse sign for the whole market.

Volume implications are now rather poor, and daily volume on the N. Y. S. E. is tending to dry up during rallies (even inter-day rallies) while it tends to expand on declines. As long as this continues, the implications are for lower prices.

On July 19 the Industrials (chart #1) penetrated their own long-term moving average. Such action in the past (while not necessarily calling for immediate trouble) has been a definite warning of a turn in investment sentiment.

Odd-lot sentiment turned less bearish during the recent decline. And while odd-lotters have remained on the selling side of the market, their rate of selling has now dropped to the lowest level in five months (since February). Thus the public's reaction to the drop has been unexpectedly optimistic ("cut back on your sales as the market declines"). From the technician's standpoint, it is bullish when the public's fears are aroused as the market declines. This has definitely not occurred so far, and until it does the odds favor the decline's not being over.



Without evincing any divergence at the recent (May 31) peaks, the Industrial Average and the advance-decline ratio have headed down together. Last week both indicators broke below their June lows, thereby confirming the continuance of the downtrend. Important reversals from down to up are often preceded by non-confirmations (one indicator refused to confirm the downside penetration of the other). This has not yet occurred.

Last week the A-D ratio on the American Exchange (see Letter 223) broke to a new 1963 low. It is now only a fraction away from breaking its October, 1962 bear market low. If this does occur, I would accept such action as exceedingly bearish. It would mean that the declining tendency of the majority of issues on the American has surpassed even the horrific action of 1962.

**CONCLUSION:** The technical factors favor lower prices (although a rally could put in an appearance first).

**TIMING** Back in Letter 209 (February 11, 1963) I published a study which showed the relationship between the highest level of technical strength in the market and the highest level of profit potential. To represent the highest level of technical strength, I used the peak of the short interest ratio. To represent the highest level of profit potential, I used the peak of the advance-decline ratio.

THE SHORT INTEREST RATIO (S.I. ratio) is obtained by dividing the total short interest on the N. Y. S. E. for any given month by the average daily volume during the same month. The higher the total short interest and the lower the average daily volume, the higher (and more bullish) the S.I. ratio.

Upon completion of a major decline, the Averages may back and fill as they construct a base for the next rise. At such times, the market is apt to attract a great many short sellers (all of whom, of course, are speculating for a further decline).

In order for an important decline to develop, there must be real selling pressure (i. e., lower prices accompanied by heavy downside volume). But when the market turns dull following a major decline, the suggestion is that the downside pressure is over and the market is technically "sold out". When this occurs, the short sellers find themselves under increasing pressure to cover and take their losses. Thus a high short interest and dull volume (i. e., a high S.I. ratio) is instrumental in building the base for the next rise. As a rule, the higher the S.I. ratio, the greater the technical strength and the greater the ensuing movement.

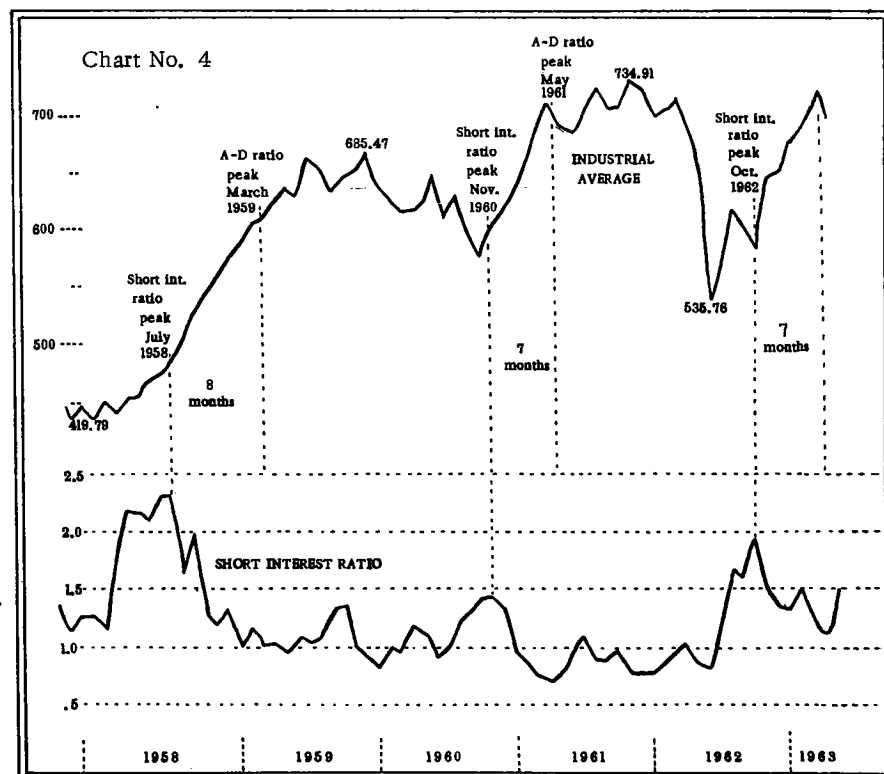
**A-D RATIO:** The typical investor tends to hold a fairly diversified list of stocks through a bull swing. The height of his profit potential during such a swing is usually the last point at which the majority of his stocks are still advancing. Since the advance-decline ratio measures the advancing or declining tendency of the majority of stocks on the Exchange, the peak on the A-D ratio is very apt to mark the peak area of profitability for a diversified portfolio during a given bull swing.

Chart No. 4 deals with the time element during the three major market advances since 1957. In the first example, note that the highest level of market strength or the peak on the S.I. ratio came in July, 1958. The peak on the A-D ratio came in March, 1959. Thus eight months elapsed between the highest level of strength and the highest level of profitability.

In the second example, the S.I. ratio struck its high in November, 1960, while the A-D ratio continued to advance until May, 1961. Thus seven months elapsed between the peak of market strength and the peak of profitability.

In the current situation, the S.I. ratio recorded its high of 1.98 in October, 1962. The odds heavily favor 1.98 being the peak for the S.I. ratio for this advance. On May 31 the A-D ratio recorded its post-crash recovery high, and this peak came seven months after the October high in the S.I. ratio.

The critical question: did the May 31 peak represent the final high for the A-D ratio on the 1962-63 advance? If it did, then the market's main profit potential is over for this rise. Based on the eight month time lapse between the high on the S.I. ratio and the peak on the A-D ratio during



Page 4 1958-59, and based on the seven month time span during 1960-61, I believe that there is a very good chance that the A-D ratio saw its peak on May 31, 1963 (seven months after the peak on the S. I. ratio).

This would suggest either a long, confusing "top formation" (such as occurred in 1961) prior to the next major decline or a shorter top (which may already have been formed) and an important decline. At any rate, the time relationship as discussed in this study suggests the strong possibility that the main upward movement (which began in June, 1962) is over.

**APOLOGIES** The little chart of Hercules Powder on page 4 of Letter 224 appeared by mistake. It should have been a chart of Homestake Mining (which by the way acts exceedingly well).

**MORE ON GOLD** My friend Eliot Janeway (a leading economist) is convinced that our gold problem is due to receive one of its worst setbacks from the current English predicament. The British Labour party has a notoriously poor record as far as defending the pound is concerned. The pound is weak enough now (with the Conservative party in power). Nevertheless, the Labour party is practically sure to take over at the coming election.

The bet: a probable run on the pound when the date is set for the next general election in Britain. And the result: a run on the pound would put terrific pressure on the dollar (at a time when the dollar is weak on its own). Any help which the dollar is called upon to give the pound will constitute an added drain on our balance of payments deficit. So, says Janeway, trouble in Britain will signal the next real trouble for the dollar.

**STOCKS** Of 444 stocks tabulated weekly at this office, 269 (or 61%) are now holding above their 30-week moving average (a sharp drop of 9% from last week). The percentage, however, is still above 50% (a hopeful sign from the standpoint of this study).

From the standpoint of relative strength, the strongest groups are now food chains (strongest stocks: Kroger and Safeway), mining and smelting (American Smelting & Refining, Cerro, St. Joseph Lead), Oil (Getty, Gulf, Standard of Jersey). The weakest groups (stocks for shorting) are aircraft (weakest stocks: Boeing, Lockheed, North American), and meat packing (Morrell, Swift). Aluminums are now turning weak with Reynolds, Kaiser and Aluminium Ltd. both in position to short on rallies. The extraordinary "head-and-shoulders" pattern in Reynolds (extraordinary because it is so perfect) indicates that RLM is worth shorting on a "pull back" to the 32 level. Note the classic diminishing volume crests through the left shoulder (LS), the head (H) and the right shoulder (RS). A pull back to the neckline at 33 (horizontal dotted line) should be accompanied by decreasing volume.

The immense descending triangle in Boeing has been violated following two years of distribution. Note the collapse in relative strength before the downside penetration. Watch this company; the market is saying that there is bad news ahead for Boeing.

Although the drug group is showing average relative strength, Richardson-Merrell and Schering are noticeably weak within this group. Both stock are in position for shorting on any rally.

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.

